

THE NEW LEGISLATION: MEANS TESTING

Judge Jack Caddell
United States Bankruptcy Court
Decatur, Alabama

The means testing provisions in 11 U.S.C. § 707(b) have been repeatedly described as a key component of the new Bankruptcy Act. The test creates a presumption of abuse in individual Chapter 7 cases under the circumstances set forth in the chart below, however, it appears that the new test will limit the availability of Chapter 7 for only a small number of debtors given the safe harbor provisions and extensive set of deductions from income permitted under § 707(b)(2)(A).

Annualized Combined Monthly Income* Equals or Falls Below Applicable Median Family Income	Annualized Combined Monthly Income Exceeds Applicable Median Family Income
↓	↓
Means test does not apply	
↓	For married debtors not filing jointly adjust income to exclude income not regularly contributed to household expenses by the non-filing spouse, then subtract deductions allowed under § 707(b)(2), multiply by 60, and if the debtor's 60-month disposable income is . . .
Check the "Presumption does not arise" box on the Statement of Current Monthly Income and Means Test Calculation form.	<div style="display: flex; justify-content: space-between;"> <div style="width: 45%;"> less than \$6,000 </div> <div style="width: 45%;"> more than \$10,000 </div> </div>
	↓
	<div style="display: flex; justify-content: space-between;"> <div style="width: 45%; text-align: center;"> Presumption does not arise </div> <div style="width: 45%; text-align: center;"> Presumption arises </div> </div>
	↓
<i>* The combined income of the debtor and the debtor's spouse is used at the front end under § 707(b)(7) to determine whether or not the means test applies.</i>	at least \$6,000, but not more than \$10,000 calculate whether the debtor's 60-month disposable income is less than 25% of the debtor's total unsecured debt . . .
	↓
	↓
	<div style="display: flex; justify-content: space-between;"> <div style="width: 45%; text-align: center;"> Yes </div> <div style="width: 45%; text-align: center;"> No </div> </div>
	↓
	<div style="display: flex; justify-content: space-between;"> <div style="width: 45%; text-align: center;"> Presumption does not arise </div> <div style="width: 45%; text-align: center;"> Presumption arises </div> </div>

On October 5, 2005, the Executive Committee of the Judicial Conference of the United States approved interim Official Form B22A, entitled Statement of Current Monthly Income and Means Test Calculation. The means testing form must be completed by each individual Chapter 7 debtor whose debts are primarily consumer debts. The top right hand corner of the form includes a checkbox in which the debtor will indicate whether or not there is a presumption of abuse.

Part I of the form applies the disabled veterans safe harbor exclusion.¹ Disabled veterans whose debts were incurred primarily during a period in which the debtor was on active duty are directed to check the “Presumption does not arise” box at the top of the form.

Other debtors must proceed to Part II of the means testing form. There is a second safe harbor provision found in § 707(b)(7) pursuant to which an individual Chapter 7 debtor with annualized combined monthly income that equals or falls below the applicable state median family income is not subject to the means test.² In Alabama, the applicable median family income in 2004 inflation adjusted dollars is \$32,762 for 1 earner, \$39,755 for a family of 2, \$48,957 for a family of 3, and \$54,338 for a family of 4.³ Add \$6,300 for each additional family member. The debtor’s current monthly income is calculated in Part II of the means testing form to determine whether the § 707(b)(7) safe harbor exclusion applies.

Calculation of Current Monthly Income for § 707(b)(7). Pursuant to § 707(b)(7)(A), no party may file a motion to dismiss under § 707(b)(2) if the combined current

¹ 11 U.S.C. § 707(b)(2)(D).

² See 11 U.S.C. § 101(39A) for the definition of median family income.

³ See www.usdoj.gov/ust/.

monthly income of the debtor and the debtor's spouse is equal to or less than the applicable median family income. Combined income is used to determine means test standing under § 707(b)(7) even when the debtor's spouse is not a joint debtor.⁴

Current monthly income is defined in 11 U.S.C. § 101(10A) as the debtor's average monthly income from all sources without regard to whether the income is taxable earned during the six calendar months prior to filing bankruptcy. Included in this definition are wages, salaries, tips, bonuses, overtime, commissions, real property income, business income, retirement income, other regular contributions to household expenses, and income from all other sources. Benefits received under the Social Security Act and as payments to victims of war crimes and terrorism are excluded.

Once the debtor's total current monthly income for § 707(b)(7) is calculated in Part II, the figure is multiplied by 12 and entered in Part III of the means testing form to determine the debtor's annualized current monthly income. If the debtor's annualized current monthly income is less than or equal to the applicable median family income,⁵ the form directs the debtor to check "the presumption does not arise" box on the top of Official Form B22A and to disregard the remaining parts of the form related to the means test deductions allowed under § 707(b)(2). The means test analysis ends here for debtors whose income equals or falls below the applicable median family income.

⁴ Section 707(b)(7)(B) provides that the income of the debtor's spouse will not be considered if the parties are separated other than for the purpose of avoiding § 707(b)(7)(A).

⁵ The applicable median family income in Alabama is \$32,762 for 1 earner, \$39,755 for 2 people, \$48,957 for 3 people, and \$54,338 for 4 people, and \$6,300 for each additional family member. See www.usdoj.gov/ust/.

Calculation of Current Monthly Income for § 707(b)(2). For all other debtors, the means test analysis continues in Part IV. At this point, combined income is used only in joint cases. For married debtors not filing jointly, Part IV applies a marital income adjustment i.e. the form directs a married debtor not filing jointly to subtract the amount of income that is not regularly contributed to household expenses by the debtor's spouse from current monthly income identified in Part II.

Calculation of Deductions. The next step in the means testing analysis involves the calculation of deductions allowed under § 707(b)(2)(A)(ii)-(iv). Part V, subpart A of the means testing form tracks the deductions allowed under § 707(b)(2)(A)(ii)(I). Section 707(b)(2)(A)(ii)(I) provides that the “debtor’s monthly expenses shall be the debtor’s applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor’s actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service”

1. National Standards

The National standards for allowable living expenses is a fixed expense allowance for food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous expenses. The IRS standards are based on the number of people in the household and the debtor's gross monthly income. The debtor is entitled to deduct the full amount of the allowance without regard to actual expenditures. The IRS collection standards are available at www.usdoj.gov/ust/.

2. Local Standards: Housing and Utilities

The Local housing and utilities standards are calculated by state, county, and family size.

For purposes of the means test, the IRS has divided the housing and utilities standards into two components, a non-mortgage expense component and mortgage/rent expense component. In Jefferson County, Alabama, the non-mortgage expense allowance is \$306 for a 1 or 2 person family, \$359 for a 3 person family, and \$413 for a family of 4 or more. The non-mortgage expense component of the housing and utilities allowance may be fully claimed even if the debtor's actual expenses are less. The mortgage/rent component of the allowance must be reduced by the debtor's average monthly payment for any debt secured by the debtor's home. If the debtor's actual mortgage payment exceeds the mortgage/rent expense allowance, line 20B of the means testing form directs the debtor to zero out the allowance. The debtor's entire mortgage payment will be deducted at line 42 as a secured debt payment.

EX. 1: In Jefferson County, Alabama the local housing and utilities mortgage/rent allowance for a family of 4 or more is \$819 and the non-mortgage allowance is \$413. For a debtor with a family of four and a monthly mortgage payment of \$1,000, the debtor will deduct \$413 for the non-mortgage allowance regardless of actual expenses and the deduction for the mortgage/rent allowance will be zero (\$819 - \$1,000). As will be discussed more below, in Subpart C the debtor will deduct the entire amount of the mortgage payment as a deduction for future payments on secured claims.

EX 2: Assume that a family of four living in Jefferson County, Alabama, has a monthly mortgage payment of \$500. The debtor will again deduct \$413 for the non-mortgage allowance, and \$319 (\$819 - \$500) for the mortgage/rent allowance. In Subpart C, the debtor will deduct the entire \$500 monthly mortgage payment.

The debtor's actual mortgage expense must be deducted from the mortgage/rent allowance component to prevent double-dipping, because future payments on secured claims are deducted separately under § 707(b)(2)(A)(iii).

3. Local Standards: Transportation Expenses

The IRS divides transportation expenses into two components: (1) vehicle operation and public transportation expenses; and (2) ownership/lease expenses. The means test calculation form tracks the IRS transportation allowance by including separate deductions for transportation expenses at line 22 and ownership/lease expenses at lines 23 and 24.

At line 22, the debtor is entitled to deduct the vehicle operation and public transportation expense regardless of whether the debtor pays expenses for operating a vehicle or uses public transportation. The IRS calculates the allowance by Region. Alabama is located in the South Census Region. If the debtor does not own a car, the debtor is allowed \$197 for operating and transportation costs. For one car the allowance is \$242 and for two cars the allowance is \$336.

For the ownership/lease expense component, line 23 directs the debtor to indicate whether the debtor owns one vehicle or two or more vehicles. The National allowance for the first car is \$475 and \$338 for a second car. In the ownership/lease expense category, the form directs debtors to subtract the average monthly payment for any debts secured by vehicles from the IRS allowance for ownership/lease expenses, up to the full amount of the allowance. If the debtor's vehicle payment exceeds the allowance, the form directs the debtor to not enter an amount less than zero. The debtor will deduct the full amount of the car payment in Subpart C of the means testing form.

4. Other Necessary Expenses

There are eight categories of "other necessary expenses" that the debtor may deduct beginning on line 25. In these categories, the debtor should deduct actual average monthly expenses for:

- **Taxes** - federal, state, and local;
- **Mandatory payroll deductions** - mandatory retirement contributions, union dues, uniform costs, etc.;
- **Life insurance** - only term life insurance on the debtor;
- **Court ordered payments** - includes spousal and child support payments;
- **Education for employment or for a physical or mentally challenged child;**
- **Childcare;**
- **Health care** - expenses not reimbursed by insurance;
- **Telecommunication services** - cell phones, pagers, call waiting, caller id, special long distance or internet necessary for the health and welfare of the debtor or dependants.

5. Additional Expenses

Subpart B of Part V tracks additional deductions allowed under § 707(b)(2)(A)(ii) for the following categories:

- **Health insurance, disability insurance, and health savings account expenses;**
- **Contributions to the care of household or family members** - expenses incurred for the support of elderly or chronically ill household or family members;
- **Protection against family violence** - expenses incurred under the Family Violence Prevention and Services Act;
- **Home energy costs in excess of the allowance specified by the IRS standards** - must be documented;
- **Education expenses for dependent children less than 18** - not to exceed \$125 per child;
- **Additional food and clothing expenses** - up to 5% (the IRS has added a calculation to the National Standards for Allowable Living Expenses chart to reflect a 5% increase in the additional food and clothing expense allowance);
- **Continued charitable contributions.**

6. Deductions for Debt Payment

Subpart C itemizes allowed deductions under § 707(b)(2)(A)(iii) and (iv) for monthly secured debt payments and priority claims. Secured and priority payments are calculated based on the total of all amounts due during the 60 months following the petition date, divided by 60. If the debtor is in default on secured payments on the petition date, divide the pre-petition arrearage by 60 to deduct past due payments on secured claims.

7. Chapter 13 administrative expenses

If the debtor is eligible to file a Chapter 13 case, Chapter 13 administrative expenses are also deducted in Subpart C. This amount is calculated based on the debtor's projected average monthly Chapter 13 plan payment multiplied by the applicable current district multiplier.

Determination of the Means Test Presumption. Once all § 707(b)(2) deductions are calculated, the total amount of all deductions are subtracted from the debtor's current monthly income in Part VI of the means testing form. This amount is multiplied by 60. If the debtor's 60-month disposable income is less than \$6,000, the presumption of abuse does not arise. If more than \$10,000, the presumption of abuse arises. If the amount is at least \$6,000, but not more than \$10,000, the debtor must proceed with the means test calculation by multiplying total non-priority unsecured debt by 25%. If the debtor's 60-month disposable income is less than 25% of the debtor's unsecured debt total, the presumption does not arise. If equal to or greater than 25% of the debtor's unsecured debt total, the presumption of abuse arises and the debtor will be ineligible

for Chapter 7 relief unless the debtor is able to rebut the presumption under § 707(b)(2)(B)(iv) by demonstrating that special circumstances exist that would decrease the debtor's income or increase expenses in an amount that would bring the debtor below the threshold trigger points for the presumption of abuse. Part VII of the means test form provides for additional expenses claimed to rebut the presumption. If the presumption of abuse arises under § 707(b)(2)(A)(I) and is not rebutted, the court may dismiss the case or, with the debtor's consent, convert same to a chapter 11 or 13 case.⁶

Application in Chapter 13. The Chapter 7 means test deductions must be used in Chapter 13 cases pursuant to § 1325(b)(3) to determine disposable income when the debtor's annualized current monthly income is greater than the applicable state median income.⁷ The term disposable income is defined in 11 U.S.C. § 1325(b)(2) as the:

[C]urrent monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less *amounts reasonably necessary to be expended* –

(A)(i) for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and

(ii) for charitable contributions (that meet the definition of “charitable contribution” under section 548(d)(3) to a qualified religious or charitable entity or organization (as defined in section 548(d)(4)) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for

⁶ 11 U.S.C. § 707(b)(1).

⁷ 11 U.S.C. § 1325(b)(3).

the continuation, preservation and operation of such business.

(emphasis added)

Section 1325(b)(3) provides that the phrase “amounts reasonably necessary to be expended” in subsection (b)(2) shall be determined using the § 707(b) means test calculations when the debtor has annualized current monthly income that exceeds the applicable median state income.

If the debtor has annualized current monthly income that is equal to or less than the applicable median family income, the means test calculations are not applicable. When the debtor’s income falls below the median income, the debtor’s disposable income is determined using Schedules I and J without reference to the means test calculations. Official Form B22C, Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income, directs below median income debtors to check the box for “Disposable income is not determined under § 1325(b)(3)” at the top of the form and to disregard the remaining sections of the form related to the calculation of deductions allowed under the means test.

Part II of Official Form B22C must be completed by all Chapter 13 debtors to determine the applicable commitment period required for the Chapter 13 plan pursuant to § 1325(b)(4) of the Bankruptcy Code. Section 1325(b)(4) defines the term “applicable commitment period” as: (i) 3 years for a debtor with annual income less than the median family income; (ii) 5 years for a debtor with annual income that is not less than the applicable state median family income; or (iii) a period that is less than 3 years or 5 years, whichever is otherwise applicable, if the plan provides for full payment of all allowed unsecured claims.